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TEL AVIV FOR AGATT

E. O. 11652: GDS

TAGS: ECON, EAID, EGEN, CY

SUBJECT: CYPRUS ECONOMY - ANALYSIS AND PROJECTIONS

REF: NICOSIA 4334 (NOTAL)

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THIS IS THIRD IN SERIES OF FOUR CABLES DEVOTED TO CYPRIOT ECONY,

IMPACT OF TURKISH INVASION, AND EMBASSY POSITION REGARDING AN AMERICAN ASSISTANCE PROGRAM.

I. SUMMARY. EMBASSY ANALYZES PRE-WAR AND CURRENT ECONOMY, AND MAKES ECONOMIC PROJECTIONS FOR 1975-76 IN CONTEXT OF WHAT WE CONSIDER PROBABLE DEVELOPMENTS.

A) CYPRUS ECONOMY, IN 1962-72 DECADE, CHARACTERIZED BY NCDYGANIC REAL GROWTH AVERAGING 7 PERCENT ANNUALLY. THIS GROWTH ACHIEVED AGAINST BACKGROUND OF STABLE PRICES, FULL EMPLOYMENT, EXPANDING AGRICULTURAL PRODUCTION AND EXPORTS, RAPIDLY DEVELOPING TOURIST SECTOR FUELING CONSTRUCTION BOOM, AS WELL AS CONSISTENT OVERALL BALANCE OF PAYMENT SURPLUSES AND HIGH FX RESERVES, DESPITE EXPANDING ANNUAL TRADE DEFICITS.

BY END OF DECADE CYPRUS RECORDED \$859 MILLION GNP (QOUW PRICES) OR \$1328 PER CAPITA, AN ECONOMIC LEVEL EQUAL TO THAT OF PROTUGAL OR YUGOSLAVIA. TOURSIT SLOWDOWN,DROUGHT, INFLATIONARY PRESSURES, TREBLED PETROLEUM AND SUBSTANTIALLY INCREASED BASIC COMMODITY PRICES COMBINED TO REDUCE REAL ECONOMIC GROWTH TO ABOUT 2 PERCENT BYSXOJ-1974.

B) ALTHOUGH 1974 PHYSICAL WAR DAMAGE MINIMAL, SECTORAL REVIEW OF POST-WAR GREEK CYPRIOT ECONOMY REVEALS SOME SEVERE LOSSES. KEY SECTORS OF AGRICULTURE AND TOURISM, BOTH MAJOR FOREIGN EXCHANGE EARNERS, EMPLOYERS AND CREATROS OF DEMAND, WERE HARDEST HIT, WITH OTHER IMPORTANT SECTORS SHARPLY CURTAILED.

INFLATION, UNEMPLOYMENT AND LARGE BUDGETARY DEFICIT HAVE BECOME MAJOR PROBLEMS. FX RESERVES REMAIN HIGH BUT COULD BE HALVED BY END 1975.

C) GOC HAS TAKEN IMMEDIATE MEASURES DESIGNED TO RAISE FUNDS FOR RELIEF/CONSTRUCTION, EASE FINALCIAL PRESSURES ON MANY BUSINESSES AND INDIVIDUALS, AND REVITALIZE ECONOMIC ACTIVITY. MEDIUM TERM PLANS INVOLVE ACCELERATION OF EXISTING INFRASTRUCTURAL IMPROVEMENTS, WHILE LONG-TERM PLANNING REMAINS EMBRYONIC.

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D) CENTRAL QUESTION IS WHETHER GREEK CYPRIOTS WILL EMERGE FROM SHOCK TO ACCEPT REALITY AND EMPLOY THEIR CONSIDERABLE ENTREPRENEURIAL AND MANAGERIAL TALENTS TO RECONSTRUCT AND RESTRUCTURE THEIR ECONOMY. DESPITE OBVIOUSLY SEVERE IMPACT OF TURKISH OCCUPATION, WE BELIEVE GREEK CYPRUS

HAS VIABLE ECONOMIC FUTURE AND THAT CYPRIOTS WILL SETTLE

DOWN AND DEVELOP IT. OVERALL PICTURE EMERGING FROM ANALYSIS IS ONE OF ECONOMY UNDER MAJOR BUT TOLERABLE SHORT - AND MEDIUM-TERM STRAIN. WITH GOC PROGRESS IN DEALING WITH IMMEDIATE PROBLEMS THROUGH ASSUMPTION OF STRONG ROLE IN DIRECTION OF ECONOMY AND WITH REVIVAL OF PRIVATE SECTOR CONFIDENCE WE FORESEE RESUMPTION REAL ECONOMIC GROWTH, ALBEIT FROM REDUCED BASE, AT END OF THREE YEAR PERIOD. HIGH FX RESERVES, AUSTERITY MEASURES AND SELECTIVE FOREIGN ASSISTANCE SHOULD PERMIT GREEK CYPRUS ECONOMY SURVIVE UNTIL THAT TIME. END SUMMARY.

II. INTRODUCTION.

1. THIS CABLE ANALYZES CYPRUS ECONOMY: ITS PRE-WAR PROSPERITY, ITS CURRENT TRUNCATION, AND ITS OUTLOOK FOR 1975-76. ANY DISCUSSION OF CURRENT OR FUTURE PERFORMANCE CYPRUS ECONOMY MUST BE PREFACED WITH IMPORTANT CAVEAT: ECONOMIC AND POLITICAL UNKNOWNNS ARE MYRIAD AND GOC STATISTICS ARE OFTEN UNAVAILABLE OR SUSEPCT, RENDERING ANALYSIS SPECULATIVE, SUBJECTIVE AND TENUOUS.

2. WE BASE DISCUSSION ON FOLLOWING PREMISES WHICH WE BELIEVE REALISTIC:

A) VIRTUALLY ALL OF CYPRUS'S GREEK POPULATION OF 500,000 MAY BE OBLIGED TO INHABIT AND GAIN LIVELIHOOD FROM 70-75 PERCENT OF ISLAND'S 3000 SQUARE MILES, (CONTAINING HIGH PERCENTAGE OF HERETOFORE UNPRODUCTIVE LAND), WHEREAS PREVIOUSLY THEY LIVED ISLAND-WIDE.

B) POLITICAL STATUS QUO WILL REMAIN BASICALLY UNCHANGED
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THROUGH MID (POSSIBLY END) 1975. E. G., REFUGEE RETURN WILL BE MARGINAL.
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C) EVEN ASSUMING FEDERAL SOLUTION, TURKISH CYPRIOTS
WILL MANAGE THEIR OWN REGION, LARGELY EXCLUDING
GREEK CYPRIOTS AND OPERATING ECONOMY WHICH IN
MANY RESPECTS WILL BE AUTONOMOUS.

D) ANY FEDERAL GOVERNMENT ESTABLISHED UNDER POLITICAL
SOLUTION WILL HAVE POWERS MAINLY IN
FOREIGN AFFAIRS, ADMINISTRATIVE COORDINATION ON SUCH
MATTERS AS POWER GENERATION AND DISTRIBUTION, URBAN
WATER SUPPLY, AND FAMAGUSTA PORT AND NICOSIA INTER-
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NATIONAL AIRPORT MANAGEMENT. FOREIGN TRADE AND TAXATION
WILL BE REGIONAL RATHER THAN FEDERAL RESPONSIBILITIES.

E) UNDER WHAT NOW APPEARS AS "BEST CASE" SETTLEMENT FORMULA,
GREEKS WOULD REGAIN FAMAGUSTA NEW CITY, WITH ITS
TOURIST AND INDUSTRIAL FACILITIES, SOME OF MORPHOU

AREA CITRUS PLANTATIONS, SOME OF CENTRAL PLAINS
GRAIN ACREAGE, AND NICOSIA INDUSTRIAL ESTATE. THIS
SOLUTION WOULD ALLOW RETURN HOME OF UP TO 70,000
REFUGEES.

III PHYSICAL WAR DAMAGE

PHYSICAL DESTRUCTION AS RESULT OF CONFLICT WAS SLIGHT.
BASIC INFRASTRUCTURE IN SOUTH - POWER PLANTS, PETROLEUM
REFINERY, PORTS, MOST INDUSTRY - SUSTAINED NO DAMAGE.
AIRPORT SUSTAINED LIGHT, REPAIRABLE BOMB DAMAGE, THOUGH
CYPRUS AIRWAYS LOST THREE OF ITS FOUR TRIDENT FLEET.
ON WEST COAST, PAPHOS SEAFRONT SUFFERED LIGHT BOMB
DAMAGE. FOUR FAMAGUSTA TOURIST HOTELS, WITH TOTAL 440
ROOM CAPACITY, TOTALLY OR PARTIALLY DESTROYED AS WAS
ONE NEW HOTEL ON NORTH COAST. NICOSIA INDUSTRIAL
ESTATE, HOUSING SOME 65 SMALL PLANTS, SUFFERED FIRE
DAMAGE AS DID WAREHOUSES IN FAMAGUSTA PORT AND IN
NICOSIA. ACCORDING TO GOC, FOREST FIRE TOOK MOST SERIOUS
TOLL, WITH 64,000 ACRES DESTROYED IN SOUTH AND ALMOST
10,000 ACRES DESTROYED IN NORTH. THUS, DESPITE
APPARENT FURY OF JULY/AUGUST HOSTILITIES, ONLY
SERIOUS LONGTERM PHYSICAL DAMAGE WAS DESTRUCTION OF
74,000 ACRES OF FOREST. MOST OF REMAINING DAMAGE
CONFINED TO TURK-CONTROLLED NORTH.

IV CYPRUS ECONOMY - PRE AND POST WAR.

PRE-WAR DEVELOPMENTS: - CYPRUS ECONOMY CAME UNDER STRAIN IN
1973. DROUGHT AND MOUNTING INFLATIONARY PRESSURES SHARPLY
REDUCED OVERALL ECONOMIC GROWTH. REAL GNP GROWTH WAS MINIMAL
2.2 PERCENT, WITH AGRICULTURAL PRODUCTION DOWN 20 PERCENT,
EXPANDING TRADE DEFICIT WITH FIRST OVERALL BALANCE OF PAYMENTS
DEFICIT (\$11.2 MILLION), AND 8 PERCENT INFLATION RATE.
HOWEVER, FULL EMPLOYMENT CONTINUED, TOURIST ARRIVALS INCREASED
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16 PERCENT, WITH EARNINGS UP 30 PERCENT, AND COPPER EXPORT
EARNINGS WERE UP 27 PERCENT DESPITE DROP IN EXPORT VOLUME.
STRAINS INTENSIFIED IN 1974. ALTHOUGH DROUGHT AND CONSEQUENT
NEED FOR HIGH GRAIN IMPORTS ENDED, TREBLED PRICE OF OIL AND
INCREASES IN BASIC COMMODITY AND RAW MATERIAL PRICES WERE
EXPECTED RESULT IN DOUBLE-DIGIT INFLATION (15 PERCENT),
RISING UNEMPLOYMENT (2 PERCENT), \$40 MILLION OVERALL BALANCE
OF PAYMENTS DEFICIT, AND DRAWDOWN OF FOREIGN EXCHANGE RESERVES TO
SIX MONTH IMPORT BILL LEVEL. IMPACT OF JULY-AUGUST 1974 WAS
IS BEST VIEWED THROUGH SECTORAL ANALYSIS:

1. AGRICULTURE AND FORESTRY:

A. TRADITIONALLY LARGEST SINGLE SECTOR OF CYPRUS ECONOMY, AGRICULTURE HAS ACCOUNTED FOR OVER 20 PERCENT OF GROSS DOMESTIC PRODUCT (GDP) IN RECENT YEARS, PROVIDED SUBSTANTIAL EXPORT EARNINGS, AND EMPLOYED 34 PERCENT OF ECONOMICALLY ACTIVE POPULATION. MAJOR PRODUCTS AND AVERAGE ANNUAL PRODUCTION VOLUMES WERE WHEAT 85,000 TONS), BARLEY 895,000 TONS), GRAPES (170,000 TONS), CITRUS FRUIT (245,000 TONS), POTATOES (173,000 TONS) AND CARROTS (16,000 TONS). CYPRUS WAS VIRTUALLY SELF SUFFICIENT IN LAMB, PORK, BEEF, POULTRY, EGGS AND MILK.

B. WAR HAS DEPRIVED GREEK SOUTH OF MORE THAN ONE-HALF OF ITS AGRICULTURALLY PRODUCTIVE LAND. MAJOR EXPORT CROP AREAS HAVE BEEN DRASTICALLY REDUCED. SOUTHERN ZONE NOW CONTAINS 20 PERCENT OF ISLAND'S PRE-WAR CITRUS FRUIT LAND, 75 PERCENT OF POTATO ACREAGE, 15 PERCENT OF CARROT-ACREAGE, 70 PERCENT OF CAROB PLANTINGS. TOBACCO LAND WITH ITS EXPORT CROP, TOTALLY UNDER TURK CONTROL. WITH REGARD DOMESTICALLY CONSUMED CROPS, ONLY 20 PERCENT OF GRAIN ACREAGE (ABOUT 36,000 TONS ANNUAL YIELD) REMAINS; 55 PERCENT OF OLIVE GROVES, 70 PERCENT OF GREEN VEGETABLE ACREAGE, AND VIRTUALLY ENTIRE NON-CITRUS FRUIT ACREAGE, INCLUDING VINEYARDS, REMAIN IN SOUTH. WHILE GOC ESTIMATES THAT 70 PERCENT OF CYPRUS' TOTAL LIVESTOCK HAVE DIED OR UNDER TURK CONTROL, INDEPENDENT ESTIMATE PUTS LOSSES AT CLOSER TO 50 PERCENT. SUPPLIES OF LOCALLY PRODUCED MEAT, POULTRY, EGGS, AND MILK MUST NOW

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BE SUPPLEMENTED BY IMPORTS. GOC CLAIMS 20 PERCENT OF NATIONAL FORESTS HAVE BEEN LOST TO NORTH, WHILE ANOTHER 15-20 PERCENT AVAILABLE IN SOUTH DESTROYED IN WAR.

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2. TOURISM:

A. THIS RAPIDLY EXPANDING SECTOR RESPONSIBLE FOR MUCH OF CONSTRUCTION BOOM AND INDIRECTLY FOR MUCH OF CYPRUS' BURGEONING NATIONAL DEVELOPMENT, ACCOUNTING FOR 10 PERCENT OF GDP IN 1972. GREEK-CYPRIOT ENTREPRENEURIAL ZEAL, LAND'S HERRICHOLOGICAL TREASURES, VARIED LANDSCAPE (MOUNTAINS, BEACHES) AND FAMILIARITY TO BRITISH POPULATION HAD CREATED IDEAL COMBINATION. IN 1973 MORE THAN 260,000 TOURISTS SPENT \$60 MILLION IN CYPRUS, UTILIZING 174 HOTELS
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WITH ABOUT 15,000 BED CAPACITY. BRITAIN WAS SOURCE 44 PERCENT OF TOURIST INFLOW.

B. GREEK CYPRIOTS HAVE LOST FAMAGUSTA AND KYRENIA, MASS TOURISM AND RETIREMENT CENTERS, AND RETAIN 18 PERCENT OF 1973 TOURIST ROOM CAPACITY, INCLUDING ONLY FOUR INTERNATIONAL STANDARD LUXURY TOURIST HOTELS. VIRTUALLY ALL NEW HOTELS UNDER CONSTRUCTION AT TIME OF INVASION IN FAMAGUSTA. WITH HIGHLY COMPETITIVE NATURE OF MEDITERRANEAN TOURISM, TOURIST EARNINGS TO SOUTH WILL PROBABLY RETURN TO ONLY TINY FRACTION OF ISLAND'S TOTAL PRE-WAR LEVEL DURING 1975.

3. INDUSTRY:

LIGHT AND MEDIUM, SMALL MANUFACTURING UNITS ACCOUNTED FOR 12 PERCENT OF GDP IN 1972, EMPLOYING ABOUT 14 PERCENT OF WORKING POPULATION. MAJOR ACTIVITIES HAVE BEEN PETROLEUM REFINING, DISTILLING, METAL FABRICATION, CLOTHING AND FOOTWEAR MANUFACTURE. PRODUCTION HAS BEEN HARD HIT BY WAR, SUSTAINING OVERALL 50 PERCENT AD VALOREM REDUCTION (GOC ESTIMATE). HOWEVER, SOUTH STILL CONTAINS BULK OF SECTOR'S MAJOR COMPONENTS: ENTIRE PETROLEUM REFINING, DISTILLING, WINERY, BREWING AND BOTTLING CAPACITY AS WELL AS MAJORITY CLOTHING/FOOTWEAR MANUFACTURING, CANNING AND CITRUS PACKING FACILITIES AND METAL FABRICATION. ALL OF THESE ARE KEY EXPORT OR IMPORT-SUBSTITUTION ACTIVITIES. IMPORTANT NICOSIA INDUSTRIAL ESTATE IN TURK HANDS AS IS FAMAGUSTA PORT WHICH HANDLED 83 PERCENT OF COUNTRY'S EXPORT-IMPORT CARGO, PRIOR TO CONSTRUCTION NEW LIMASSOL PORT.

4. PUBLIC FINANCE:

1972 REVENUE TOTALED \$150 MILLION AGAINST EXPENDITURES OF \$165 MILLION; MOST OF DEFICIT DOMESTICALLY FINANCED. REVENUE YIELD EQUALLED 17 PERCENT GNP. REVENUE SYSTEM BASED ON INDIRECT TAXATION WITH IMPORT DUTY AND EXCISE TAX ACCOUNTING FOR 44 PERCENT TOTAL REVENUE. INCOME TAXES YIELDED ONLY 15 PERCENT OF TOTAL REVENUE. OTHER MAIN REVENUE SOURCES INCLUDED RENTS, ROYALTIES, INTEREST AND TAXES ON CAPITAL. FOR 1974, GOC ESTIMATES \$137 MILLION IN REVENUES (INCLUDING ATHENS SUBSIDY) AND \$263 MILLION CONFIDENTIAL

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IN EXPENDITURES, LEAVING \$126 MILLION DEFICIT. WITH

DEFICIT AT SOME 45 PERCENT OF ESTIMATED EXPENDITURES, GOC ALREADY FACES CASH FLOW CRISIS. IN 1975 DEFICIT COULD APPROACH \$200 MILLION, CONFRONTING GOC WITH STILL MORE INTENSE FLOW PROBLEM.

5. CONSTRUCTION:

WHILE BOOM HAD LEVELED OFF BY 1974, SECTOR CONTINUED TO EXPAND, PROVIDING ABOUT 9 PERCENT GDP AND EMPLOYING ABOUT 10 PERCENT LABOR FORCE. GOC-DIRECTED CREDIT SQUEEZE, OVERBUILDING, AND LAYOFFS CHARACTERIZED SECTOR BEFORE JULY 1974. SINCE WAR, WORK HAS RESUMED AT REDUCED LEVELS ON MANY INCOMPLETE BUILDINGS. WITH LOSS OF SERVICES OF SEVERAL THOUSAND TURK-CYPRIOI LABORERS, CONSTRUCTION EMPLOYMENT PROSPECTS FOR GREEKS HAVE IMPROVED SOMEWHAT BUT THIS COULD BE SHORT-TERM STIMULATION.

6. MINING:

COOPER AND IRON PYRITE MINING PROVIDED 3.6 PERCENT OF GDP AND EMPLOYED 1.4 OF LABOR FORCE PRE-WAR. SECTOR GENERALLY CHARACTERIZED BY DECLINING PRODUCTION AND DWINDLING RESERVES. EXCEPTION WAS COPPER; THOUGH DOWN IN VOLUME, IT REGISTERED 27 PERCENT INCREASE IN EXPORT EARNINGS IN 1973 AS RESULT SHARP INCREASE WORLD COPPER PRICES. SOME 75 PERCENT OF COPPER, IRON PYRITES AND ASBESTOS MINING AREA REMAINS IN SOUTH. HOWEVER, LOSS OF MAJOR NORTHERN ORE EXPORTING PORT OF KARAVOSTASI LOSES SUBSTANTIAL PROBLEM. SOUTH RETAINS BOTH OF ISLAND'S CEMENT PLANTS BUT ONLY 25 PERCENT OF STONE QUARRYING CAPACITY.

7. EMPLOYMENT:

A. IN 1973 REGISTERED UNEMPLOYMENT AVERAGED 1.1 PERCENT OF ECONOMICALLY ACTIVE POPULATION OF ABOUT 275,000. AGRICULTURE, TOURISM, MANUFACTURING AND CONSTRUCTION

SECTORS EMPLOYED ABOUT 60 PERCENT THIS POPULATION, WITH GOVERNMENT LARGEST SINGLE EMPLOYER (22,000). ALTHOUGH CONFIDENTIAL

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SKILLED LABOR IN SHORT SUPPLY, NUMBER OF UNEMPLOYED UNIVERSITY GRADUATES WAS TRENUHV 702-4\$.

B. FROM THIS BRIGHT PICTURE OF VIRTUAL FULL EMPLOYMENT, ECONOMY HAS MOVED TO REGISTERED UNEMPLOYMENT RATE APPROACHING 10 PERCENT, WITH PERHAPS ADDITIONAL 10 PERCENT REGISTERED. (PROBABLE TOTAL OF 55,000) AS IN PAST, RATE WOULD BE HIGHER IF NATIONAL GUARD WERE DEMOBILIZED. EMIGRATION, WHICH ALREADY ACTING AS IMPOSSIBLE SAFETY VALVE (1973 TOTAL OF 1300 EMIGRANTS), WILL INCREASE SUBSTANTIALLY IN 1975.

8. INFLATION:

A. MODEST INFLATIONARY PRESSURES (5 PERCENT PER ANNUM) EVIDENT BY 1972, PRIMARILY RESULT OF INFLATION IN ECONOMIES OF CYPRUS' MAJOR TRADING PARTNERS. IN 1973, PRICES REGISTERED 8 PERCENT INCREASE; BY MID-1974, ANNUAL 12 PERCENT INFLATION RATE HAD ARRIVED. WITH MOST WAGE CONTRACTS TIED TO RETAIL PRICE INDEX INCREASES, SPIRALING INFLATION CHARACTERIZED SITUATION.

D. WAGE PUSH IS NO LONGER FACTOR IN POST WAR ERA, AND WE ESTIMATE THAT INFLATION RATE MAY STABILIZE IN PRESENT 1-15 PERCENT RANGE, FURTHER DEPRESSING REAL INCOME.

EXCESS DEMAND FOR CONSTRUCTION SUPPLIES ARISING FROM NEW
PUBLIC WORKS PROJECTS AND HEAVY DEMAND FOR FOOD STAPLES
MAY CREATE DOMESTIC INFLATIONARY PRESSURES THOSE AREAS,
AS WILL CREDIT MORATORIA. HOWEVER, AS BEFORE, RISING
PRICES OF IMPORTED GOODS WILL REMAIN MAJOR FACTOR IN
DETERMINING CYPRUS INFLATION RATE.
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9. FOREIGN ASSISTANCE:

SOME 85 PERCENT OF DEVELOPMENT BUDGET WAS DOMESTICALLY

FINANCED, WITH MOST BILATERAL FOREIGN AID CHanneled INTO CULTURAL AND EDUCATIONAL FIELDS. GOC HAS RECEIVED RELATIVELY HIGH LEVEL IBRD PROJECT LENDING (ABOUT \$60 MILLION IN LOANS OUTSTANDING BY 1973), PRIMARILY IN FIELDS OF ELECTRIFICATION* TRANSPORTATION, SANITATION, AND WATER DEVELOPMENT. GOC HAD BEEN PARTICULARLY SUCCESSFUL IN ASORPTION OF TECHNICAL ASSISTANCE UNDER UNDP PROGRAM. CONFIDENTIAL

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UNDP MIXED FARMING AND RURAL DEVELOPMENT PROJECTS HAVE BEEN HARD HIT BY INVATION, WITH LIVESTOCK AND PROJECT AREAS LOST OR INACCESSIBLE.

10. REFUGEES:

NUMBER OF DISPLACED PERSONS HAS NOT STABILIZED AT ABOUT 160,000. GOC AND UNHCR ESTIMATE THAT SOME 45-70 THOUSAND REPRESENT HARD CORE DESTITUTE WHO WILL BE TOTALLY DEPENDENT UPON GOC FOR FORESEEABLE FUTURE. BALANCE 100,000

ARE EITHER SELF-SUPPORTING OR HOUSED IN OVERCROWDED CONDITIONS. WITH \$22 MILLION IN HELP UNDER UNHCR PROGRAM, WELL-ORGANIZED GOC DISPLACED PERSONS RELIEF AND REHABILITATION SERVICES IS COPING WELL WITH THE PROBLEM. REAL TEST AND STRAIN OF ABSORPTION WILL NOT BE FACED UNTIL 1975 AND LATER. (SEE NICOSIA 4334 FOR DETAILED ASSESSMENT REFUGEE PICTURE AS OF DECEMBER 1, 1974.)

11. FOREIGN TRADE:

A. IN RECENT YEARS, CYPRUS' IMPORT BILL GENERALLY 2 1/2 TIMES ITS EXPORT EARNINGS. IN 1972, EXPORTS VALIED AT \$134 MILLION WERE OFFSET BY \$315 MILLION WORTH OF IMPORTS TO PRODUCE \$181 MILLION TRADE DEFICIT. MAJOR EXPORTS WERE CITRUS (\$35 MILLION), POTATOES (\$18 MILLION), COPER (\$14 MILLION) AND WINES AND SPIRITS (\$13 MILLION). RAW MATERIALS ACCOUNTED FOR 37 PERCENT OF IMPORTS; CONSUMER GOODS ACCOUNTED FOR 35 PERCENT. AGRICULTURAL COMMODITIES AND MINERALS ACCOUNTED FOR 63 PERCENT AND 17 PERCENT OF EXPORTS RESPECTIVELY. UK WAS CYPRUS' MAJOR TRADING PARTNER, PROVIDING 28 PERCENT IMPORTS AND TAKING 41 PERCENT EXPORTS.

B. ACCORDING TO LATEST GOC DATA, IMPORTS FOR FIRST NINE MONTHS 1974 REMAIN 14 PERCENT ABOVE LEVEL CORRESPONDING 1973 PERIOD; THIS WOULD INDICATE THAT TOTAL 1974 IMPORT BILL WILL BE ABOUT \$400 MILLION, ONLY 10 PERCENT BELOW 1973 IN VALUE BUT LOWER IN VOLUME AS RESULT INFLATION. EXPORTS FOR FIRST NINE MONTHS 1974

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EQUALLED LEVEL OF CORRESPONDING 1973 PERIOD AND BY YEAR END WILL PROBABLY TOTAL \$160 MILLION, ONLY 10 PERCENT BELOW 1973. RESULTANT \$240 MILLION TRADE DEFICIT WOULD BE ABOUT 10 PERCENT BELOW THAT OF 1973.

C. 1975 FOREIGN TRADE PERFORMANCE WILL PROBABLY PRESENT SHARPLY CONTRASTING PICTURE. EXCEPT FOR PETROLEUM AND FOOD, 1975 IMPORTS CAN BE EXPECTED REGISTER 50 PERCENT DECLINE IN VALUE. WITH HALF OF LIVESTOCK LOST, GRAIN IMPORTS WILL PROBABLY FALL BELOW 1973 LEVEL, WHEN VIRTUALLY ENTIRE DOMESTIC PRODUCTION LOST TO DROUGHT, AND 125,000 TONS WHEAT AND BARLEY IMPORTED FROM US ALONE. WE ESTIMATE IMPORT BILL IN \$250 MILLION RANGE AND EXPORTS DECLINING 50-60 PERCENT TO \$70 MILLION FOR 1975. RESULTANT TRADE DEFICIT WOULD TOTAL \$180 MILLION, 15 PERCENT BELOW THAT ANVISED FOR 1974. THUS OUR ANALYSIS INDICATES ACCEPTABLE FOREIGN TRADE PERFORMANCE IN 1974, AND IN 1975 IMPORTS 3 1/2 TIMES EXPORTS BUT TRADE DEFICIT SOME 30 PERCENT BELOW THAT OF 1973. THIS IS BRIGHTER PICTURE THAN GOC HAS BEEN PREDICTING.

12. BALANCE OF PAYMENTS:

A) CYPRUS BALANCE OF PAYMENTS STRUCTURE IS STRANGELY SKEWED. ANNUAL CURRENT ACCOUNT DEFICITS WERE MORE THAN OFFSET BY INVISIBLES (UK BASE EXPENDITURE -

\$60 MILLION; TOURISM - \$60 MILLION; PRIVATE LONG-TERM CAPITAL MOVEMENTS - \$42 MILLION AND ANKARA SUBSIDY TO TURK CYPRIOTS - \$35 MILLION), PRODUCING SUBSTANTIAL OVERALL SURPLUSES OF (\$27 MILLION IN 1970, \$47 MILLION IN 1971- AND \$19 MILLION IN 1972). WITH IMPORT BILL EQUAL TO SOME 60 PERCENT OF GNP, MAINTENANCE OF HIGH FOREIGN EXCHANGE RESERVES HAS BEEN IMPORTANT FACTOR IN GOC FINANCIAL POLICY. SINCE 1971, RESERVES HAVE HOVERED AROUND \$300 MILLION LEVAL, SUFFICIENT TO COVER 12-13 MONTHS OF IMPORTS.

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USIA-06 AID-05 COME-00 EB-07 FRB-01 TRSE-00 XMB-02

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B. IMPORTANT INVISIBLE RECEIPTS WILL SHOW RADICAL DECLINE
IN 1974 SECOND SEMESTER. WHILE BALANCE OF PAYMENTS
DEFICIT MAY ONLY BE 20 PERCENT HIGHER THAN PRE-WAR
ESTIMATES, (PERHAPS \$60 MILLION), OUTLOOK FOR 1975 IS
GRAVER. TOURIST EARNINGS WILL BE VASTLY REDUCED.
BRITISH BASE EXPENDITURES ALREADY REDUCED AS RESULT
DEPARTURE MOST DEPENDENTS, AND ANKARA SUBSIDY NO LONGER
FLOWING BACK TO GOC THROUGH CENTRAL BANK AND EXPENDITURES
OF TURKISH POPULATION. PRIVATE LONGTERM CAPITAL INFLOWS
(LARGELY REMITTANCES FROM OVERSEAS CYPRIOTS) MAY DECLINE,
BUT WILL STILL REMAIN IMPORTANT FACTOR. UNDER CURRENT
CONDITIONS, WE ESTIMATE THAT OVERALL BALANCE OF PAYMENTS
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DEFICIT FOR 1975 WILL BE DOUBLE THAT ENVISIONED FOR 1974,
OR ABOUT \$120,MILLION.

C) GOC ORIGINALLY PREDICTED 50 PERCENT FALL IN FX RESERVES
BY END 1976) YET, BY AUGUST 31, RESERVES STILL

TOTALED ABOUT \$290 MILLION, EQUAL TO DECEMBER 1973 LEVEL. WE ESTIMATE THAT BY DECEMBER 31, 1974 RESERVES MAY BE REDUCED 17 PERCENT FROM DECEMBER 1973 LEVEL TO ABOUT \$240 MILLION. REDUCTION MAY WELL BE SMALLER. HOWEVER, BY END 1975, WE ESTIMATE THAT RESERVES WILL DROP 50 PERCENT TO \$120 MILLION. AT 1975 ESTIMATED IMPORT LEVEL OF \$250 MILLION, THESE RESERVES WOULD COVER MORE THAN NINE MONTHS OF IMPORTS. THUS, GOC TRADITIONAL PRUDENT RESERVE POLICY HAS BOUGHT TIME IN THIS CRISIS AND SHOULD SERVE AS CUSHION THROUGH 1975 AND PERHAPS EVEN 1976.

V. GOC ECONOMIC PLANNING FOR NEW REALITIES.

IMMEDIATE, MEDIUM AND LONGTERM PLANNING ARE UNDERWAY, TO VARYING DEGREES.

1. IMMEDIATE MEASURES EFFECTED:

A) REDUCTION OF WAGES, SALARIES AND PROFITS BY 30 PERCENT IN BOTH PUBLIC AND PRIVATE SECTOR. MOST FUNDS REALIZED UTILIZED FOR REFUGEE RELIEF; COMPANIES ABLE PROVE WAR-RELATED LOSSES CAN KEEP WAGE DEDUCTIONS.

B) HOUSE RENTS REDUCED 20 PERCENT; REDUCTION BUSINESS RENTS UNDER CONSIDERATION.

C) REDUCTION OF INTEREST RATES PAYABLE ON BANK DEPOSITS AND CREDITS.

XAD) TEMPORARY RESTRICTIONS ON TERMINATION OF EMPLOYMENT.

E) DEBT RELIEF LEGISLATION PROVIDING FOR SUSPENSION OF FORCED SALES AND VOLUNTARY OR COURT MEDIATED REDUCTION AND STRETCH-OUT DEBT PAYMENTS.

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F) GOC HAS APPROPRIATED ADDITIONAL \$4.1 MILLION UNDER 1974 DEVELOPMENT BUDGET AIMED AT PROVIDING EMPLOYMENT AND INCREASING INDUSTRIAL PRODUCTION.

G) CREDITS FOR RELIEF AND REACTIVATION OF FARMERS AND STOCK BREEDERS;

H) CREDIT GUARANTEES FOR PUBLIC CORPORATIONS (ELECTRICITY, TELECOMMUNICATIONS, WATER).

2. MEDIUM TERM PLANNING:

A) INFRASTRUCTURE -- MODERN DEEPWATER PORT, FINANCED
UNDER IBRD LOAN, ALREADY IN PLACE IN LIMASSOL.
ANCILLARIES --HEAVY CRANES, WAREHOUSES, PASSENGER
TERMINAL --BEING COMPLETED. PLANS FOR DEVELOPMENT/
IMPROVEMENT OF LARNACA AND PAPHOS PORTS BEING
ACCELERATED. NEW AIRPORT, UTILIZING OLD MILITARY
AIRSTRIIP, UNDER CONSTRUCTION NEAR LARNACA AND
SCHEDULED FOR COMPLETION BY JANUARY. FIELD WILL
PROVIDE SHORT RANGE COMMERCIAL FEEDER SERVICE TO
ATHENS, BEIRUT AND TEL AVIV. IBRD-FINANCED
FEASIBILITY STUDY NEW NICOSIA-LIMASSOL ROAD PROCEEDING
ON SCHEDULE, WITH NEGOTIATIONS FOR AWARD OF DESIGN/
ENGINEERLSCG STUDY UNDERWAY.GOC CONVERTING SECONDARY
NICOSIA-LARNACA ROAD LINK TO TWO LANES. PLANS FOR
EXPANSION LIMASSOL INDUSTRIAL AND TOURIST CAPACITY
BEING FORMULATED. WORK ON FIRST STAGE OF PAPHOS
WATER DEVELOPMENT SCHEME --\$100 MILLION PARTICALLY
IBRD-FINANCED PROJECT WHICH WILL IRRIGATE SOME
5000 ACRES IN SOUTHWEST CREATING NEW SOURCE CITRUS,
GRAPE AND VEGETABLE PRODUCTION-- HAS BEEN ACCELERATED.
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B) INDUSTRY: EXPORT CREDIT GUARANTEE PROGRAM, IN BLUE-
PRINT STATE BEFORE WAR, WILL BE OPERATIONAL SHORTLY.
IT IS INTENDED TO STIMULATE EXPORTS CLOTHING, SHOES,
AND PLHCESSED FOOD PRODUCED IN SOUTH.

C) AGRICULTURE: GOC GRANTS WILL BE USED TO ENCOURAGE
ESTABLISHMENT INTENSIVE GREENHOUSE CULTIVATION OF
VEGETABLES FOR EXPORT. POULTRY, EGG AND MEAT
PRODUCTION BEING STIMULATED THROUGH GRANTS TO BREEDERS, AND
OFFICIALS ESTIMATE THAT CYPRUS WILL RETURN TO SELF SUFFICIENCY
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IN POULTRY AND EGGS WITHIN TWO YEARS, ALTHOUGH NEED FOR MEAT
IMPORTS WILL CONTINUE.

3. LONGTERM PLANNING IS AREA GOC ECONOMIC PLANNERS HAVE
YET TO CONFRONT. YET, POSSIBILITIES AND PROJECTS ARE
UNDER INFORMAL DISCUSSION WITHIN GOC AND PROVATE SECTOR.
--REDEVELOPMENT OF UNDERPOPULATED MOUNTAIN VILLAGES
INCLUDING LABOR INTENSIVE ROAD AND WATER PROJECTS.
--INTENSIFICATION OF AGRICULTURE IN SOUTHWEST,
ACCELERATION IRRIGATION WORKS AND INTRODUCTION SUCH
NEW CASH CROPS AS AVOCADOS, PREVIOUSLY GROWN ONLY
EXPERIMENTALLY IN CYPRUS.
--CREATION OF NATIONAL SHIPPING LINE.
--CONSTRUCTION SHIP BUILDING AND REPAIR FACILITY.
--ESTABLISHMENT FREEPORT/INDUSTRIAL ZONE IN LIMASSOL.
--UNIFICATION CYPRUS' FRAGMENTED CLOTHING AND SHOE INDUSTRY
ASSURING ECONOMIES OF SCALE AND QUALITY CONTROL NEEDED
INCREASE EXPORTS.

VI CONCLUSION.

A. TO GREAT EXTENT, GREEK CYPRIOT ECONOMIC FUTURE DEPENDS
ON GREEK CYPRIOTS' ACCEPTANCE OF REALITY, SOCIAL
PSYCHOLOGY, WILL, AND INTERPRETATION OF THEIR NATIONAL
FUTURE. WHILE ECONOMIC IMPACT OF TURKISH INVASION HAS
CERTAINLY BEEN SEVERE, WE DO NOT SHARE GOC VIEW THAT
GREEK CYPRUS HAS NO VIABLE ECONOMIC FUTURE, ASSUMING

PREMISES FOR SOLUTION ESTABLISHED IN THIS ANALYSIS.

B. GOC IMMEDIATE MEASURES HAVE MAINTAINED MODERATELY BRISK LEVEL ECONOMIC ACTIVITY. MEDIUM AND LONG TERM PLANNING REMAIN LIMITED, GENERALLY INVOLVING ACCELERATION OF EXISTING PROJECTS, WHILE BUSINESS SLOWDOWN ALREADY BEGINNING. GOC HAS SHOWN WILLINGNESS TO ASSUME CONCRETE DIRECTION OF ECONOMY, AND THIS REPRESENTS NEW CONCEPT FOR LAISSEZ-FAIRE GOVERNMENT WHOSE EXPERIENCE LIMITED TO INDICATIVE ECONOMIC PLANNING. THESE PROGRAMS REPRESENT IMPORTANT FIRST STEPS TOWARD DEALING WITH PROBLEMS OF UNEMPLOYMENT, LOSS OF MAJOR PARTS OF INFRASTRUCTURE, AND REDUCTION OF EXPORTS. NONETHELESS, THEY REMAIN PALLIATIVES; MORE COMPRE-
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HENSIVE, EFFECTIVE AND IMAGINATIVE PROGRAMS WILL BE NEEDED.

C. TWO KEYSTONES IN CYPRUS ECONOMY--AGRICULTURE AND TOURISM--HAVE SUFFERED VERY BADLY. GIVEN "BEST CASE" POLITICAL SOLUTION, BOTH SECTORS CAN RECONSTRUCT AND READJUST, PROVIDED WILL EXISTS. CYPRIOT PRIVATE SECTOR HAS LEARNED TO INVEST AND PLAN DESPITE UNCERTAIN POLITICAL CLIMATE OF PAST 10 YEARS. WE BELIEVE PRIVATE SECTOR WILL REGAIN ITS SELF CONFIDENCE PROVIDING GOC ASSUMES SUSTAINED AND STRONG ROLE IN DIRECTING ECONOMY. THESE FACTORS, COUPLED WITH PROGRESS IN DEALING WITH MAJOR IMMEDIATE PROBLEMS--REFUGEE ABSORPTION, UNEMPLOYMENT, DEFICIT FINANCING OF GOC BUDGET-- COULD BRING RESUMPTION OF REAL ECONOMIC GROWTH, ALBEIT FROM REDUCED BASE, AT END OF THREE YEAR PERIOD. HIGH FX RESERVES, AUSTERITY MEASURES AND SELECTIVE FOREIGN ASSISTANCE SHOULD PERMIT CYPRUS ECONOMY SURVIVE UNTIL THAT TIME.
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